In the United States Bankruptcy Court
for the
Southern District of Georgia
Savannah Division

In the matter of:	)	
	)	Chapter 11 Case
CLASSIC AUTO PAINT & BODYWORKS, INC.	)	Number 93-40730
Debtor	)	
FIRST UNION NATIONAL BANK	)	
Movant	)	
v.	)	
CLASSIC AUTO PAINT & BODYWORKS, INC.	)	
Respondent	)	

FILED
at 11 O'clock & 50 min A M
Date 3-10-94
MARY C. BECTON, CLERK
United States Bankruptcy Court
Savannah, Georgia

MEMORANDUM AND ORDER
ON MOTION FOR RELIEF FROM STAY

This Order involves three related Chapter 11 cases; Frank J. Hernandez, Chapter 11 Case Number 93-40680 (hereinafter "Hernandez"), Classic

Auto Paint & Bodyworks, Inc., Chapter 11 Case Number 93-40730 (hereinafter "Classic Auto"), and Classic Collision & Insurance Repairs, Inc., Chapter 11 Case Number 93-40681 (hereinafter "Classic Collision"). First Union National Bank ("First Union") filed a Motion for Relief from Stay, and an evidentiary hearing was held on February 15, 1994. Uncontradicted evidence introduced or stipulated by the parties reveals that the real estate which is the subject of the motion, Hernandez' personal residence, is valued at $670,000.00. Mellon Bank holds the first mortgage on the property in the principal amount of approximately $325,000.00. First Union holds a second deed to secure debt covering the property with a total debt including principal, interest and accrued late charges of $308,039.22. In addition, there are unpaid *ad valorem* taxes due on the property in the approximate amount of $26,000.00. In short, unless there is demonstrated to be some invalidity in the security instruments held by Mellon Bank and/or First Union, First Union has met its burden pursuant to 11 U.S.C. Section 362(d)(2)(A) of showing that there is no equity in the property, after considering expenses of sale.

In response to the evidence in support of the First Union Motion, Hernandez argued that he had filed, on February 15, 1994, an action under 11 U.S.C. Section 548 seeking to set aside the deed to secure debt executed in favor of First Union in October 1992, within one year of the date of filing of this Chapter 11 case,

on the ground that the debtor received less than reasonably equivalent value in exchange for the transfer. Based on previous rulings of this Court, I advised the parties that, although a debtor is not permitted to file a counterclaim asserting such a cause of action in response to a motion for relief, nevertheless, if a colorable or *prima facie* case is made out that there is some substantive invalidity in the secured party's collateral documents or other cause of action which would permit the Debtor to avoid its obligation to the Movant, then the Motion for Relief must be denied in order that such litigation can be prosecuted in a court of competent jurisdiction. The pending adversary proceeding could conceivably lead to such a result. The mere pendency of an action against First Union, however, will not allow Hernandez to withstand an immediate grant of the motion. Rather, it is Hernandez' ability to show that some potentially favorable result might occur.

After a lengthy evidentiary hearing, Hernandez argued additional grounds than those asserted in its adversary proceeding existed for the Court's denial of the Motion for Relief from Stay. Because I have concluded that Hernandez is correct in his contentions, the findings of fact in this case will be limited to those narrow facts on which that portion of his argument was based.

FINDINGS OF FACT

On November 28, 1992, Debtor, Frank J. Hernandez, executed and delivered to First Union National Bank a deed to secure debt conveying his interest in his residence located at 113 Herb River Drive, Savannah, Chatham County, Georgia, to secure an indebtedness in the amount of $485,000.00. *See* Movant's Exhibits "A" and "D". Prior to the execution and delivery of this debt deed, Hernandez, Classic Auto and Classic Collision were obligated to First Union on a number of separate notes, all of which had either matured by their terms or were in arrears. To secure those loans, First Union held an assignment of certain certificates of deposit as well as security agreements conveying to First Union the inventory, fixtures, furniture and equipment, accounts receivable, and similar collateral of Classic Auto, Classic Collision and a Dairy Queen restaurant in which Hernandez held an interest. First Union became aware that Hernandez and his companies were unable to cure the arrearages or pay off the notes which had matured, and as a result, discussions occurred between Hernandez and the First Union's account officer in which the First Union agreed to make an "interest only" loan for a period of approximately one year to assist him in restructuring his debts in exchange for Hernandez granting to the Bank a second security deed covering his residence.

The parties vigorously disputed the circumstances under which this transaction took place. Hernandez claimed that he granted the security deed in his residence in response to threats by the Bank that it would foreclose on all the business assets of the Debtor corporations and put them out of business, while First Union claims that the security deed was requested simply because First Union would be converting debt, with an approximate five-year payout, to a longer term obligation, and because it was inappropriate under the Bank's lending regulations to extend long-term credit without holding real estate as collateral. The parties also hotly disputed the issue of whether the granting of the security deed in Hernandez' residence constituted a grant or a conveyance of additional collateral by Hernandez or whether it was given as collateral in exchange for the Bank's release of collateral which had previously been pledged by the corporations. Neither of these issues need to be, nor will be, resolved in this order.

Whatever the nature of the parties' discussion regarding the security deed, it is undisputed that, after the discussion, Hernandez consulted with non-bankruptcy counsel, met in his attorney's office with the First Union's loan officer, and executed a number of documents to implement the arrangement that had been agreed upon. Among those documents was the deed to secure debt. *See* Movant's Exhibit

"D".

Doug McCoy, the Bank's representative, testified that he did not recall whether the unofficial witness and the Notary Public who witnessed and attested Hernandez' signatures on the deed to secure debt were present at the "closing" in counsel's office. The attesting witnesses were identified by their signatures as Trudy Collins and Diana Scott, both employees of First Union National Bank. When asked specifically whether they had traveled from the offices of First Union to Hernandez' attorney's office, Mr. McCoy was unable to testify that they had attended the closing. Consistent with Mr. McCoy's testimony that he could not recall whether Ms. Collins or Ms. Scott had attended the closing, Cheryl Hernandez, Debtor's wife, testified that she attended the closing at the attorney's office and that neither of the witnesses who attested the deed to secure debt were present at that time. I therefore conclude, for the purposes of this hearing, that the signatures of Trudy Collins and Diana Scott were affixed to the deed to secure debt after the closing took place, that neither of them saw Mr. or Mrs. Hernandez sign the deed to secure debt, nor were they present at the time the deed to secure debt was delivered to the Bank's representative at closing.

CONCLUSIONS OF LAW

As previously noted, the merits of Debtor's adversary proceeding against First Union, initiated on the same day this matter was heard, can not be appropriately adjudicated as a part of this proceeding. *See* Matter of Rice, 82 B.R. 623, 626 (Bankr. S.D.Ga. 1987); 2 Collier, ¶ 362.08[3] at 362-77. Nonetheless, where a party, who holds a security interest in property, has moved for relief from stay to pursue its state law remedies against that property, the validity of the party's security interest is a central issue in determining whether granting relief from stay is appropriate. Accordingly, this court has previously held that:

> [W]hen presented with evidence in defense of a motion for relief that strongly supports an inference that the lien [on a piece of real property] might be held invalid in an [adversary] proceeding, this court would be compelled to deny the motion and leave the stay in effect for a sufficient time to allow the debtor to pursue other litigation.

Matter of Rice, 82 B.R. 623, 626 (Bankr. S.D.Ga. 1987) (*citing* 2 Collier, ¶ 362.08[3] at 362-77; In re Cedar Bayou Ltd., 456 F.Supp. 278 (W.D.Pa. 1978); In re Talley Well Service, Inc., 45 B.R. 149 (Bankr. E.D.Mich. 1984)). *Accord* In re Hunt's Pier Assoc., 143 B.R. 36, 50 (Bankr. E.D.Penn. 1992) ("If a bankruptcy court has a serious doubt

about the validity of the movant's security interest in the debtor's property, this factor weighs heavily upon the court's determination of a §362(d) motion."). Therefore, some preliminary consideration of the merits of Debtor's adversary proceeding against First Union is warranted in resolving the motion presently before the court.

Hernandez' residence is located in Chatham County, Georgia. Consequently, the nature, extent and validity of First Union's security interest in the property must be determined under the laws of the State of Georgia. *See* In re Southern Transfer & Storage Co, 157 B.R. 691, 693 (Bankr. M.D.Fla. 1993); In re Hunt's Pier Assoc., 143 B.R. 36, (Bankr. E.D.Penn. 1992). Under Georgia law, a deed to secure debt is required to be attested in the same manner as a mortgage in order for the deed to be eligible for recordation. *See* O.C.G.A. § 44-14-61. Under O.C.G.A. §44-11-33, a real property mortgage must be attested to by both an official and unofficial witness to be admitted to record. Accordingly, a deed to secure debt must be properly attested to in the same manner, by both an official and unofficial witness.

In Georgia, a third party is entitled to demonstrate by extrinsic proof that an instrument was defectively attested. American Distributing Co. v. Reid, 101 Ga. App. 477, 114 S.E.2d 299 (1960). Attestation is, in its strictest sense, the act of

witnessing the actual execution of an instrument, such as a deed, mortgage or deed to secure debt. *See* Wood v. Davis, 161 Ga. 690, 694, 131 S.E. 885 (1926); Matter of Fleeman, 81 B.R. 160, 163 (Bankr. M.D.Ga. 1987). One Georgia court has held, however, that a sufficient attestation occurred when a grantor exhibited a deed bearing his signature and declared to the attesting witnesses that it was his signature. *See* Hansen v. Owens, 132 Ga. 648, 657, 64 S.E. 800 (1909). *Contra* White & Co. v. Magarahan, 87 Ga. 217, 13 S.E. 509 (1891) (exhibition of a pre-executed deed is merely an acknowledgement rather than an attestation).

In the instant proceeding, there is uncontradicted evidence that, under either standard of attestation set forth above, the security deed, under which First Union claims secured status in this case, was not properly attested to by either the official or unofficial witness. Thus, the question narrows to what effect the improper attestation has on First Union's status as a secured creditor in this case.

An improperly attested deed to secured debt is valid between the parties to the deed, but it does not provide constructive notice of the contents or existence of the deed, even if it is recorded. *See* Propes v. Todd, 89 Ga. App. 308, 312, 79 S.E.2d 346, 350 (1953); American Distributing Co. v. Reid, 101 Ga. App. 477,

478, 114 S.E.2d 299, 301 (1960); In re Hammett, 286 F. 392, 394 (N.D.Ga. 1923); Matter of Updike, 93 B.R. 795, 797 (Bankr. M.D.Ga. 1988); Matter of Fleeman, 81 B.R. at 163. Furthermore, the rights of a grantee in an unrecorded or unperfected deed to secure debt on real property are subordinate to the rights of a subsequent bona fide purchaser who takes the property without notice. *See* O.C.G.A. §§ 44-2-1, 44-2-2; 44-14-63; Dickson v. Chapman, 153 Ga. 547, 112 S.E. 830 (1922); Matter of Clifford, 566 F.2d 1023, 1026 (5th Cir. 1978). Accordingly, a recorded, but improperly attested, security deed is insufficient to perfect the rights of the secured party as against a bona fide purchaser. *See* Propes v. Todd, 89 Ga. App. 308, 312, 79 S.E.2d 346 (1953); American Distributing Co. v. Reid, 101 Ga. App. 477, 114 S.E.2d 299 (1960); Matter of Fleeman, 81 B.R. at 162-63.

In a proceeding under Chapter 11 of the Bankruptcy Code, the debtor-in-possession is granted all the rights and powers of a bankruptcy trustee. *See* 11 U.S.C. §1107(a); In re Southern Transfer & Storage Co, 157 B.R. at 693. Section 544(a)(3) of the Code confers upon a trustee the status of a bona fide purchaser, and it provides:

> (a) The trustee shall have, as of the commencement of

> the case, and *without regard to any knowledge of the trustee* or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by
>
> > (3) a bona fide purchaser of real property, other than fixtures, from the debtor against whom applicable law permits such transfer to be perfected, that obtains the status of a bona fide purchaser at the time of the commencement of the case, whether or not such a purchaser exists . . .

11 U.S.C. § 544(a)(3) (emphasis added).

Thus, even though Hernandez is the grantor under the deed, he may, by virtue of his status as debtor in possession and without regard to any actual knowledge he possesses, assume the status of a bona fide purchaser of real property under section 544(a)(3) and avoid any liens against real property which a bona fide purchaser would take priority over under state law. *See e.g.*, Zilkha Energy Co. v. Leighton, 920 F.2d 1520, 1523 (10th Cir. 1990) U.S. v. Sierer, 139 B.R. 752, 755 (N.D.Fla. 1991); Matter of Updike, 93 B.R. at 797; In re Price, 97 B.R. 264, 265 (Bankr. E.D.N.C. 1989). Because First Union's improperly attested deed to secure

debt in Hernandez' residence is insufficient to perfect its interest as against a bona fide purchaser under the laws of the State of Georgia, Mr. Hernandez, as a debtor in possession, has the power under section 544(a)(3) to avoid its interest thereunder.

Therefore, I conclude that Mr. Hernandez has made out a *prima facie* case that First Union's security interest may be avoidable under Section 544(a)(3) of the Bankruptcy Code. The ultimate decision on the extent and validity of First Union's interest in the residence must await a final decision in the adversary proceeding filed on February 15, 1994, styled Frank J. Hernandez v. First Union National Bank of Georgia, Adversary Proceeding Number 94-4022. For the purposes of this motion, however, Debtor has made a sufficient showing to satisfy the requirements of Rice, supra, that the secured status of First Union is in substantial question. Accordingly, on the record before me, the property is valued at $670,000.00 and the only unquestioned security interest in the property is $325,000.00 plus delinquent taxes of $26,000.00. Therefore, Movant has not met its burden of proving lack of equity as required by 11 U.S.C. Section 362(g), and as a result, its Motion for Relief From the Automatic Stay must be denied at this juncture in the case.

Accordingly, the Motion for Relief from Stay is denied without

prejudice, so that upon a final determination of the secured status of its loan First Union may again seek relief.

ORDER

Pursuant to the foregoing Findings of Fact and Conclusions, IT IS THE ORDER OF THIS COURT that the Motion for Relief from Stay of First Union National Bank is hereby DENIED.

Lamar W. Davis, Jr.
United States Bankruptcy Judge

Dated at Savannah, Georgia
This 9th day of March, 1994.